BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2013-55-C - ORDER NO. 2014-517

JULY 8, 2014

IN RE:	South Carolina Telephone Coalition Petition to Modify Alternative Regulation Plans Filed Pursuant to S.C. Code Section 58-9-576 (B) to Take Into Account Recent Action by the Federal Communications Commission	)))))	ORDER DENYING SCCTA MOTION

I. INTRODUCTION AND PROCEDURAL BACKGROUND

The issue before the Public Service Commission of South Carolina ("Commission") is whether the South Carolina Universal Service Fund ("State USF") is required to be reduced when a company increases its basic local service rates to meet a rate floor established by the Federal Communications Commission ("FCC"). For the reasons stated herein, there is no such requirement, and the Motion of the South Carolina Cable Television Association ("SCCTA") to reduce payments from the State USF is denied.

This Docket was initiated on February 8, 2013, when the South Carolina Telephone Coalition ("SCTC") filed a Petition asking the Commission, pursuant to S.C. Code Ann. § 58-9-280(H), to establish new price caps for basic local residential service provided under alternative regulation plans filed by certain SCTC member companies. Under existing law, companies electing alternative regulation pursuant to S.C. Code Ann. § 58-9-576(B) are permitted to increase basic local exchange service rates up to the

statewide average ($14.35 for basic residential service) before they are required to freeze those rates for two years. See S.C. Code Ann. § 58-9-576(B)(3). Thereafter, the companies are permitted to increase basic local service rates annually based on an inflation-based index. See S.C. Code Ann. § 58-9-576(B) (4). By its Petition, SCTC asked the Commission to modify the rate cap for basic local residential service from the *statewide* average rate to the applicable *nationwide* average rate for such service as determined by the Federal Communications Commission ("FCC"). The only thing that changed as a result of SCTC's Petition is the amount of the cap. No party objected to the Commission granting the modification, or to the affected companies increasing their basic local residential service rates as a result of the modification. SCCTA intervened in this Docket, stating that it supported the modification requested by SCTC, but arguing that the change would require adjustments to the size of the State USF. See SCCTA Petition to Intervene at p. 2. On March 22, 2013, SCTC filed verified testimony in support of its Petition along with a proposed order, stating that no party objected to the proposed order, but that each party had reserved its rights to address any other issues that may arise in this docket.

We granted SCTC's Petition by Order dated April 10, 2013, finding that the requested modification is in the public interest and is consistent with the Telecommunications Act of 1996, because it will help ensure the continued provision of high-quality basic local exchange telephone service at affordable rates to all citizens; will assist in ensuring that additional costs are not shifted to the State of South Carolina from the federal jurisdiction; and will ensure that South Carolina companies can continue to

draw support from the federal universal service support mechanisms. See Order No. 2013-201 at p. 8. On or around May 6, 2013, a number of companies filed tariffs to increase rates for basic residential local exchange service, in accordance with our Order.

On June 14, 2013, SCCTA filed a Motion to Require Reductions in Amounts Drawn from the USF ("Motion"). By its Motion, SCCTA asks the Commission to reduce State USF for six companies (the "RLECs") that increased basic local residential rates to move toward the FCC's rate floor.[1] SCCTA argues (1) the Commission's USF plan requires carriers of last resorts' ("COLR") USF withdrawals to be "revenue neutral"; therefore, State USF withdrawals must be reduced to offset the additional revenues from the recent local rate increases; and (2) S.C. Code Ann. § 58-9-280(E) requires reduction in USF withdrawals because it provides that the USF shall be the difference between the cost of providing basic local service and the maximum amount the COLR can charge for the service. The RLECs filed a Response on July 1, 2013, and SCCTA filed a Reply on July 10, 2013. The parties agreed that oral arguments should be scheduled before the Commission on the Motion. See Hearing Officer Directive dated July 19, 2013.

The Commission held oral arguments on September 11, 2013, with Chairman G. O'Neal Hamilton presiding. Frank R. Ellerbe III, Esquire, and Bonnie D. Shealy, Esquire, represented the South Carolina Cable Television Association ("SCCTA"). Bonnie D. Shealy, Esquire, also represented tw telecom of south carolina llc. M. John

[1] The six RLECs named in the motion are Chester Telephone Company, Home Telephone Company, Lockhart Telephone Company, PBT Telecom, Ridgeway Telephone Company, and West Carolina Rural Telephone Cooperative. The FCC will establish a rate floor effective July 1, 2014 that will be equal to the nationwide average residential rate, which is expected to be in the range of $16.50 to $17.00. We permitted companies to increase rates up to the current nationwide residential average rate of $15.62 effective July 1, 2013, in order to lessen the impact of a single increase in July 2014.

Bowen, Jr., Esquire, and Margaret M. Fox, Esquire, represented the South Carolina Telephone Coalition ("SCTC"). Patrick W. Turner, Esquire, represented BellSouth Telecommunications, LLC d/b/a AT&T South Carolina. C. Jo Anne Wessinger Hill, Esquire, represented Frontier Communications of the Carolinas, Inc. John J. Pringle, Esquire, represented Sprint Communications Company, LP ("Sprint"). Jeanne W. Stockman, Esquire, represented United Telephone Company of the Carolinas, LLC, d/b/a CenturyLink ("CenturyLink"). John M. S. Hoefer, Esquire, represented Verizon Long Distance, LLC; Verizon Select Services, Inc.; MCI Communications Services, Inc. d/b/a Verizon Business Services; and MCImetro Access Transmission Services, LLC. Nanette S. Edwards, Esquire, represented the South Carolina Office of Regulatory Staff ("ORS").

Oral arguments were presented by Mr. Ellerbe on behalf of SCCTA, Mr. Bowen on behalf of SCTC, and Mr. Pringle on behalf of Sprint.

II. BACKGROUND AND HISTORY OF THE STATE USF

At the oral argument on SCCTA's Motion, the Parties discussed the background and history of the State USF. Because it is relevant to the instant proceeding, we reiterate here a brief summary of the background and history of State USF. A more complete history is set forth in our Order No. 2010-337 in Docket No. 2009-326-C, dated July 13, 2010.

Universal service is the concept that everyone, regardless of where they live, should have access to basic local telephone service at affordable rates, and that rates and services should be comparable in rural and urban areas. The challenge in achieving this

goal is that service in densely populated urban areas is relatively inexpensive to provide, while service in sparsely populated rural areas can be very costly.

Both Congress and the South Carolina General Assembly have codified policies to preserve and advance universal service. Section 254 of the Federal Telecommunications Act of 1996 provides that quality services should be available at just, reasonable, and affordable rates; that customers in rural and high-cost areas should have access to telecommunications and information services that are reasonably comparable to those provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas; that all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service; and that there should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service. See 47 U.S.C. § 254(b)(1)-(5).

On the state side, S.C. Code Ann. § 58-9-280(E) provides in part: "In continuing South Carolina's commitment to universally available basic local exchange telephone service at affordable rates and to assist with the alignment of prices and/or cost recovery with costs, and consistent with applicable federal policies, the commission shall establish a universal service fund (USF) for distribution to a carrier(s) of last resort."

Following three (3) rounds of hearings to adopt guidelines, select appropriate cost models and methodologies, and size the fund, the Commission ordered implementation of the State USF beginning October 1, 2001. See Commission Order No. 2001-419.

In Order No. 2001-419, we found that implementation of the State USF is necessary to remove implicit support from rates and make the funding explicit, and that this will ensure the continuation of universal service to all residential and single-line business customers in South Carolina. Order No. 2001-419 at 32. Implicit support is support that is "built into" rates for other services. For example, long distance service rates historically have been priced above cost to help support basic local service, which is priced below cost. When markets are opened to competition, however, competitors can undercut rates that are priced above cost. In this manner, the COLR loses those revenues and the implicit support they provide. See id. The concept of universal service funding is to identify that implicit support and make it explicit – i.e., move it to a universal service fund – so that it continues to be available to support the provision of basic local service at affordable rates.

Rather than making an immediate and dramatic shift from a system of implicit to explicit support, we took a more cautious approach and addressed universal service concerns by ordering a phased-in implementation of the State USF with the first phase effective October 1, 2001. Id. at 33-36. The operation of the State USF and the phase-in from implicit to explicit support are revenue neutral to the ILECs in the sense that, before an ILEC may receive any funding from the State USF, that ILEC must first reduce rates containing implicit support, dollar for dollar. Id. at 42. Since access charges were a prime source of the implicit subsidy for basic local exchange services, we initially approved a reduction in access charges by fifty percent (50%) and allowed the recovery

of those revenue amounts from the State USF. Id. at 33. We also included in the State USF maximum state funding for Lifeline service for low-income consumers. Id. at 35.

We provided for further phases related to additional funding of the State USF, but held that any LEC applying for such funding from the State USF must file detailed cost data with the Commission clearly demonstrating that implicit support exists in the rates the LEC proposes to reduce. Id. at 35. In order to ensure that no company's withdrawal exceeds allowable State USF for that company, we directed that results from the cost models and methodologies be updated by each company before that company's State USF withdrawal exceeds one-third of its company-specific State USF amount. Id. at 42. Three companies have previously hit the one-third mark and those companies updated their cost results accordingly. See Order No. 2004-452 at p. 21.

We found that the State USF will benefit rural areas by preserving and advancing universal service, and further found that, if a mechanism to ensure the continued provision of affordable basic local exchange telephone service to all citizens were not put into place, customers in rural areas would be most impacted. Id. at 44.

SCCTA and Southeastern Competitive Carriers Association appealed our orders establishing and implementing the State USF on numerous grounds. The Supreme Court affirmed the Commission's orders in all substantive respects. Office of Regulatory Staff v. Public Service Commission of South Carolina, 374 S.C. 46, 54, 647 S.E2d 223, 227 (2007).

III. DISCUSSION

SCCTA is the moving party in this proceeding, and must show that the law and our prior orders require that State USF be reduced when a COLR increases the rate for its basic local exchange telephone service. SCCTA argues (1) the Commission's USF plan requires carriers of last resorts' ("COLR") USF withdrawals to be "revenue neutral;" therefore, State USF withdrawals must be reduced to offset the additional revenues from the recent local rate increases; and (2) S.C. Code Ann. § 58-9-280(E) requires reduction in USF withdrawals because it provides that the USF shall be the difference between the cost of providing basic local service and the maximum amount the COLR can charge for the service.

As SCTC argues, there is no requirement that State USF be adjusted when COLRs increase rates for basic local service. In fact, the General Assembly expressly provided a mechanism for alternatively-regulated companies to increase rates for basic local exchange service, subject to certain limitations. See S.C. Code Ann. § 58-9-576(B)(3)-(4). The only thing that has changed in this proceeding is the amount of that cap – from *statewide* average to *national* average rates – and the Commission found that modification to be in the public interest. See Order No. 2013-201 at pp. 7-8.

SCCTA argues that the State USF must be revenue neutral and, therefore, State USF must be reduced when basic local service rates are increased. However, the "revenue neutrality" requirement in our prior orders on State USF specifically relates to the removal of implicit support from rates for services *other than* basic local exchange

service. The State USF Guidelines, adopted in Commission Order No. 2001-996, provide in relevant part:

> Revenue Neutrality
>
> - Effective with implementation of the USF, incumbent LECs should reduce prices for intrastate services *that include support for universal service* to offset the gross amount received from the USF. Such price reductions shall be designed to be revenue neutral to the carrier upon implementation of the USF.

(Emphasis added.) Thus, the only revenue neutrality requirement is that carriers reduce *implicit* support by one dollar for every corresponding dollar they draw from the State USF. COLRs have done that and are drawing USF on a revenue neutral basis today. Basic local rates do not include implicit support. They are the rates that are being supported by State USF. See Tr. at p. 42, lines 8-10; S.C. Code Ann. § 58-9-280(E)(5). Increasing rates for basic local service merely moves those rates closer to cost. This furthers one of the goals articulated by the General Assembly, i.e., "to assist with the alignment of prices and/or cost recovery with costs." See S.C. Code Ann. § 58-9-280(E).

SCCTA's argument that S.C. Code Ann. § 58-9-280(E)(4) requires the State USF to be reduced because the maximum amount these COLRs may charge for basic local service has increased is likewise off the mark. SCCTA's argument misunderstands the manner in which the State USF was sized and in which it operates.

SCCTA's argument confuses the *maximum* size of the State USF ($340 million) and the *actual* size of the State USF. The high cost portion of State USF for the 2012-2013 fund year was approximately $28.5 million – less than 10% of the theoretical

maximum.[2] SCCTA's argument that a change in the maximum amount a COLR may charge for basic local exchange service will impact the "size" of the fund is correct. It would be relevant in recalculating the theoretical maximum size of the fund – i.e., the $340 million. The Commission established a cautious, phased-in approach to ensure that State USF would be implemented gradually, as companies identified and removed implicit support from other rates. The Supreme Court of South Carolina affirmed the Commission's approach and expressly approved the manner in which the Commission established a maximum fund size of $340 million, with the actual size to be implemented gradually. See Office of Regulatory Staff v. Public Service Comm'n, 374 S.C. 46, 58-59, 647 S.E.2d 223, 229-30 (2007). The Court found the Commission had properly calculated the size of the State USF at $340 million, using the formula mandated by the General Assembly, and that the State USF does not violate S.C. Code Ann. § 58-9-280(E)(4). Id. The Court also approved the Commission's efforts to ensure oversight over the size of the fund, specifically the requirement to conduct new cost studies once a specified portion of the $340 million fund has been allocated. 374 S.C. at 58, 647 S.E.2d at 230; see also Order No. 2001-419 at p. 42, ¶ 22; Tr. at pp. 45-47 (Commission has required that companies seeking more than one-third of their eligible State USF conduct new cost studies). SCCTA is correct that *the $340 million maximum size* may fluctuate, a point that was expressly recognized by the Supreme Court. See 374 S.C. at 59, 647 S.E.2d at 230 ("the sizing of the fund is flexible because such variables as federal funding, subscriber line charge, and cost requirements determined by updated studies

[2] The six companies at issue in this proceeding currently receive less than 20% of the amount of State USF for which they are eligible. See Tr. at p. 45, line 23 through p. 46, line 5.

may continually affect the fund's size"). It is important to remember, however, that the fund's size of $340 million is a theoretical maximum, and the companies actually are receiving *far less* in State USF support than the "difference between the cost of providing basic local exchange telephone service and the maximum amount they can charge ...," as provided for in S.C. Code Ann. § 58-9-280(E)(4). The fallacy in SCCTA's argument is the erroneous assumption that a fluctuation in the theoretical maximum size of the fund would require a reduction in the actual implemented portion of the fund. That is simply not the case.

This is not the first time we have concluded that the amount a COLR charges for basic local service is relevant only in calculating the theoretical maximum size of the fund. We previously concluded:

> In any case, *the maximum amount the COLR can charge for basic local service is relevant only in calculating the theoretical maximum size of the fund*, which has already been accomplished. The Commission sized the State USF based on the difference between the cost of providing basic local service and the maximum amount the COLR can charge for that service, as mandated by S.C. Code Ann. § 58-9-280(E)(4). This established the theoretical maximum size of the fund for that COLR. The actual size of the State USF is less than 15% of the theoretical maximum size, and that percentage is shrinking. This is because distributions from the State USF are only made after a carrier has demonstrated through cost studies that implicit support is contained in certain rates, and the carrier has reduced those rates that contain implicit support. Only then can the carrier draw State USF, on a dollar-for-dollar basis (i.e., the support is shifted from implicit support embedded in rates to the explicit State USF funding mechanism).

Order No. 2010-337 in Docket No. 2009-326-C, at p. 25, ¶ 11 (citations omitted) (emphasis added). SCCTA was a party to that proceeding and did not appeal Order No. 2010-337.

SCCTA also misunderstands the concept of implicit support in the context of the matter under consideration in this Motion. SCCTA argues that COLRs are recovering their entire $340 million cost through a combination of explicit and implicit support. See Tr. at p. 24, lines 15-21 ("... under the theory of the Phase-In Plan, ... at all times the combination between implicit subsidy and explicit always gave those companies the $340 million. So they've always had every bit of support that they were entitled to.") This argument erroneously assumes that implicit support has remained static over the last 12 years. That assumption is clearly incorrect. The FCC's recent and ongoing universal service and intercarrier compensation reforms have reduced or limited the amount of support many rate of return carriers will receive. With respect to intercarrier compensation alone, the FCC's USF-ICC Reform Order required SCTC companies to identify the amount of compensation they were receiving from other carriers [i.e., implicit support built into access and other rates] and move it to the Connect America Fund ("CAF"), with the requirement that the support be reduced by 5% each year.[3] The amount of the first two reductions in intercarrier compensation for the companies at issue here has already exceeded any increased revenues they will receive from residential rate increases, and that support will continue to be phased out. See Tr. at p. 40 (the six companies at issue in this proceeding have lost over $900,000 as a result of intercarrier compensation reductions in just the past two years); Tr. at p. 51 (the intercarrier

[3] Report and Order and Further Notice of Proposed Rulemaking, Connect America Fund; A National Broadband Plan for Our Future; Establishing Just and Reasonable Rates for Local Exchange Carriers; High-Cost Universal Service Support; Developing an Unified Intercarrier Compensation Regime; Federal-State Joint Board on Universal Service; Lifeline and Link-Up; Universal Service Reform – Mobility Fund, WC Docket Nos. 10-90, 07-135, 05-337, 03-109; GN Docket No. 09-51; CC Docket Nos. 01-92, 96-45; WT Docket No. 10-208; and FCC 11-161, rel. Nov. 18, 2011 ("USF-ICC Reform Order"), at ¶ 899.

compensation reductions for the past two years alone exceed the amount of revenues the six companies will receive as a result of increases in basic residential rates).

Furthermore, the suggestion that implicit support has remained static is contrary to every available industry statistic and trend. Incumbent local exchange carrier access lines – and the revenues that go along with them – are declining precipitously as consumers migrate to competitive services, including wireless service. See Tr. at p. 49. Not only are access lines declining, but they are doing so in an environment where housing units are growing, creating an even bigger gap. See Tr. at pp. 49-50. As COLRs, incumbent local exchange carriers are obligated to provide service to all requesting customers. They must maintain the entire network and build out to new homes, despite declining access lines and revenues.

SCCTA's biggest complaint seems to be that they "are paying money into the fund and not getting any out." Tr. at p. 18, lines 17-18. Both Congress and the South Carolina General Assembly have directed that all carriers contribute to the support of universal service. See S.C. Code Ann. § 58-9-280(E)(2); 47 U.S.C. § 254(b)(4). The South Carolina General Assembly directed the Commission to establish a State USF for distribution *to COLRs*. See S.C. Code Ann. § 58-9-280(E). COLRs are carriers who have "the obligation to provide basic local exchange telephone service, upon reasonable request, to all residential and single-line business customers within a defined service area." S.C. Code Ann. § 58-9-10(10). SCTC companies are COLRs. SCCTA companies are not, because they choose not to undertake that obligation. State USF provides critical support to companies that rely on such support to recover the cost of

providing service to high-cost customers. Federal support has been on a steady decline, with more and more of the burden being shifted to the states as the FCC reforms federal USF and intercarrier compensation support mechanisms. It is in the public interest to maintain state funding, and to allow the companies to maximize federal funding to the greatest extent possible, to ensure the continued provision of affordable basic local exchange service.

IV. FINDINGS AND CONCLUSIONS

1. As the moving party, SCCTA must show that the facts and the law require the result proposed by its Motion.

2. The South Carolina General Assembly has delegated to the Commission by statute the authority to address all matters related to the State USF, including establishing the State USF and adopting guidelines necessary for the funding and management of the State USF. S.C. Code Ann. § 58-9-280(E).

3. The Supreme Court affirmed in all substantive respects the Commission's determinations regarding sizing and implementing the State USF in the manner in which it currently operates. See Office of Regulatory Staff v. Public Service Commission of South Carolina, 374 S.C. 46, 647 S.E.2d 223 (2007). The Court also approved the Commission's efforts to ensure oversight over the size of the fund, specifically the requirement to conduct new cost studies once a specified portion of the $340 million fund has been allocated. 374 S.C. at 58, 647 S.E.2d at 230; see also Order No. 2001-419 at p. 42, ¶ 22; Tr. at pp. 45-47 (Commission has required that companies seeking more than one-third of their eligible State USF conduct new cost studies).

4. As we have previously held, the maximum amount the COLR can charge for basic local service is relevant only in calculating the theoretical maximum size of the fund, which has already been accomplished. See Order No. 2010-337 at p. 25. The Supreme Court concluded that the Commission properly sized the State USF based on the difference between the cost of providing basic local service and the maximum amount the COLR can charge for that service, as mandated by S.C. Code Ann. § 58-9-280(E)(4).

5. There is no requirement that State USF be reduced when a company increases its basic local service rates to meet a rate floor established by the Federal Communications Commission ("FCC"), either in state law or in prior Commission orders. In fact, state law expressly allows alternatively-regulated companies to adjust rates for basic local exchange telephone service, subject to certain limitations. See S.C. Code Ann. § 58-9-576(B)(3)-(4).

6. The "revenue neutrality" requirement in our prior orders on State USF specifically relates to the removal of implicit support from rates for services other than basic local exchange service. The implemented portion of the State USF has been sized on a revenue neutral basis. Basic local rates do not include implicit support and the revenue neutrality requirement does not apply to basic local service rates.

7. As we stated in Order No. 2013-201, allowing alternatively-regulated companies to adjust basic local residential service rates to the national average rates to enable those companies to retain federal funding is in the public interest and is consistent with the Telecommunications Act of 1996. Allowing companies to have this flexibility will help ensure the continued provision of high-quality basic local exchange telephone

service at affordable rates to all citizens; will assist in ensuring that additional costs are not shifted to the State of South Carolina from the federal jurisdiction; and will ensure that South Carolina companies can continue to draw support from the federal universal service support mechanisms. See Order No. 2013-201 at p. 8. Allowing companies the flexibility to retain federal funding on the one hand, while taking state funding away on the other, would not be in the public interest and would not further the goals of universal service.

8. The SCCTA Motion should be denied, since SCCTA has not shown that the facts and law mandate the result proposed by its Motion. The facts and law mandate denial of the Motion.

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED THAT:

The Motion of the South Carolina Cable Television Association ("SCCTA") to reduce payments from the State USF is denied. This decision is based on the findings and conclusions listed above, and is:

(1) consistent with South Carolina law and prior Commission decisions, including:

(a) S.C. Code Ann. 58-9-280(E) (requiring the Commission to establish the State USF and providing the method for sizing of the State USF);

(b) the Commission's prior orders, particularly Order No. 2001-419, sizing and establishing the State USF in the revenue-neutral manner in which it currently operates, and Order No. 2010-337, finding that the maximum amount a COLR can charge for basic local service is

relevant only in calculating the theoretical maximum size of the fund; and

(c) the Supreme Court's decision in Office of Regulatory Staff v. Public Service Commission of South Carolina, 374 S.C. 46, 647 S.E.2d 223 (2007), which affirmed the Commission's State USF orders in all substantive respects; and

(2) consistent with federal law, policy, and procedure, as specifically required by State law. See S.C. Code Ann. 58-9-280(E) (requiring that the State USF be "consistent with applicable federal policies" and "not inconsistent with applicable federal law"); see also 47 U.S.C. § 254(b) (delineating federal universal service policies); and

(3) in the best interest of South Carolina's citizens because it will continue the Commission's commitment, in keeping with the South Carolina General Assembly's directive, to ensure the continued availability of affordable basic local exchange telephone service for all South Carolina consumers.

This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:

Nikiya Hall, Chairman

ATTEST:

Swain E. Whitfield, Vice Chairman

(SEAL)